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DOES PUBLIC DEBT IMPACT ECONOMIC GROWTH IN ZAMBIA? AN ARDL-BOUNDS TESTING APPROACH

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Abstract

This study examines the dynamic impact of aggregate public debt on economic growth in Zambia from 1970 to 2017. In the analysis, the study also estimated the relative impact of domestic public debt and foreign public debt on economic growth in Zambia. Using the autoregressive distributed lag (ARDL) bound testing methodology, the results show that aggregate public debt has a positive impact on economic growth in Zambia, both in the short run and in the long run. The empirical results further reveal that the relative impact of public debt on economic growth in Zambia is dependent on the type of debt under consideration and is time-invariant. Domestic public debt was seen to be negatively related to economic growth, while its foreign counterpart had a positive impact, both in the short run and in the long run. To ensure sustainable economic growth and sustainable public debt levels, the study recommends the country to, among other things, match financial resources with the country's absorptive capacity; continuously and effectively manage its debt composition and structure to reduce currency and maturity risks; and to continue implementing structural and financial reforms that promote the efficient utilisation of public debt, such as, expanding the tradable sectors.

Keywords: Public debt, domestic public debt, foreign public debt, economic growth, Zambia, ARDL

JEL Classification : H62, H63, O47

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1. Introduction

The debate regarding the impact of public debt – domestic and foreign – on economic growth has been ongoing since the beginning of organised society (Fetter, 1980: 111). Since then, the debate has attracted several empirical studies in both developing and developed countries, focusing mostly on foreign public debt and very little attention to domestic public debt (See, for example, Salotti and Tcecroci, 2012; Rodrik, 2008; Clements *et al.*, 2003). Despite the vast volume of literature on these empirical studies, the impact of public debt on economic growth has generally been inconclusive, possibly due to differences in econometric methodologies, variations in datasets, or to other country heterogeneity factors.

The empirical evidence from most of the past studies on this topic, however, suggests that public debt has a strong negative impact on economic growth through the normal crowding out effect (Gómez-Puig and Sosvilla-Rivero, 2018; Eberhardt and Presbitero, 2015; Panizza and Presbitero, 2013; Egert, 2012). Most of these previous empirical studies suffered from two major pitfalls. First, the studies focussed on foreign public debt, thus ignoring the impact of domestic public debt on economic growth (see Uzun *et al.*, 2012; Cordella *et al.*, 2010; Clements *et al.*, 2003). Nowadays, most developing countries are either reorganising their banking systems to fully develop domestic credit markets – predominantly secondary markets for long-term financing requirements; or innovating their financial instruments in order to rely on domestic public debt and less on foreign debt (Dahou *et al.*, 2009). Second, numerous past empirical researches have relied exclusively on the cross-sectional methodology which fails to explicitly explain the potential biases arising from cross-country heterogeneity (see Gómez-Puig and Sosvilla-Rivero, 2018; Égert, 2015; Kourtellos *et al.*, 2013; Checherita-Westphal and Rother, 2012).

Against this backdrop, this paper endeavours to investigate the dynamic impact of public debt on economic growth in Zambia over the period from 1970 to 2017. The study also examines the relative impact of domestic and foreign public debt on economic growth in the study country. This study is different fundamentally from other past studies in that it estimates two separate models – the aggregated public debt model and the disaggregated public debt (domestic and foreign public debt) model – so as to expound on the dynamics of public debt and economic growth in Zambia. This specification will allow the study to suggest country specific policies based on the research findings. Also, unlike other past researches on this topic

that have exclusively depended on conventional cointegration approaches, this study uses the autoregressive distributed lag (ARDL) bounds testing method for the regression analyses.

The rest of the study is organised as follows: Section 2 discusses the trends on public debt and economic growth in Zambia. Section 3 reviews related literature on the debt-growth link, while Section 4 discusses the study methodology and presents the empirical results and the analysis. Section 5 concludes the study.

2. Public Debt and Economic Performance in Zambia

Since 2010, the Zambian economy was on the rise, driven profoundly by booming copper export prices, increased electricity generation, massive construction and industrialisation, and rapid growth in the service sector (Ministry of Finance “MOF”, 2017). By, 2015, the average gross domestic product (GDP) growth rate per annum of Zambia was 6.9%, making it the fastest growing economy in sub-Saharan Africa (World Bank, 2016a). However, a mixture of weak performances in mining, construction and service sectors and lower levels of public investment between 2015 and 2017 lowered annual GDP growth rate in 2017 to 3.8% (Central Statistical Office “CSO”, 2017; Smith *et al.*, 2016). Subsequently, the revenues have underperformed with emergence of large primary deficits reaching 12% and 8.8% of GDP in 2015 and 2016, respectively (MOF, 2017).

During the period 2010 - 2017, the public debt developments in Zambia have been rapid and drastic. As reported by the International Monetary Fund (IMF) (2017a), Zambia is at a high risk of debt distress following an exponential growth in its total public debt since 2012. Historically, public debt and the costs of debt servicing in Zambia were growing in the 1980s, with government spending outstripping revenues, and foreign exchange falling continuously (Clark and Allison, 1989). During this period, Zambia had finite borrowing alternatives, especially in the 1980s and early 2000s, being limited to organisations such as the World Bank, IMF and the African Development Bank (International Bank for Reconstruction and Development, 2017). To date, the country has diverse sources of borrowing, including access to global financial markets.

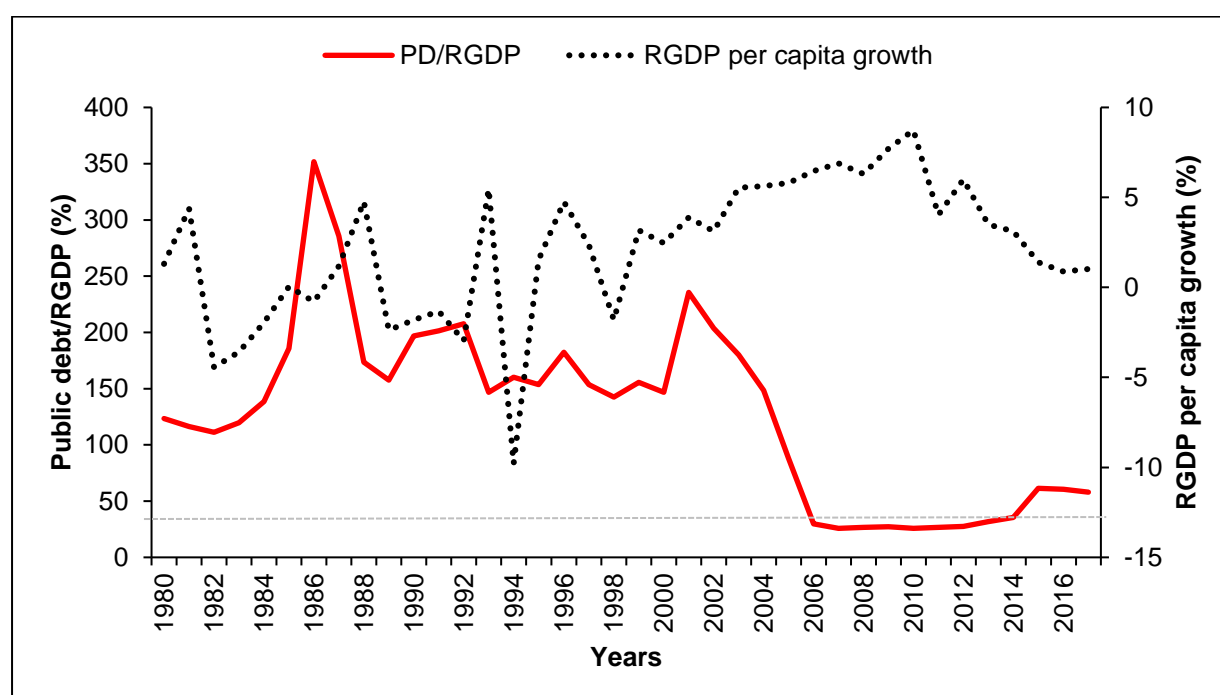
The growth in public debt during the period under review, 1970 to 2017, has been a result of the compounding effect of both domestic and foreign public debt. Growth in domestic public debt in Zambia has been largely driven by the following factors: (1) rising domestic interest

rates in the 1980s and 1990s; (2) accumulation of domestic debt arrears, pension arrears and other forms of compensations payment obligations in the 1980s; (3) budget allocation overruns by the central government; (4) introduction of new government securities; (5) increased issuance of government securities; and (6) increased contingency liabilities from state owned enterprises (Bank of Zambia, 2017a; World Bank, 2017; World Bank, 2016b; African Forum and Network on Debt and Development, 2011). For instance, the Bank of Zambia issues treasury bonds every two months as part of government efforts to deepen the country's capital markets; and treasury bills every fortnight following improved domestic liquidity (Bank of Zambia, 2017a).

The demand for the government securities come largely from the banking sector, state pension funds and insurance companies (Bank of Zambia, 2017a; Government of the Republic of Zambia “GRZ”, 2007). Bridging loans have also been a major source of short-term debt for the Zambian government, reaching 4% of GDP in 2016 (Bank of Zambia, 2017a). Furthermore, the debt by parastatals is explicitly guaranteed by the government of Zambia, accounting for 2.3% of GDP in September 2017 (IMF, 2017a). A combination of these aforementioned developments in the domestic capital markets has culminated in growing stocks of domestic public debt in Zambia.

Figure 1 presents the trends in public debt and economic growth in Zambia between 1980 and 2017. Public debt (PD) is expressed as a ratio of real GDP, while economic growth is measured by the real GDP per capita growth rate per annum.

Figure 1: Trends in Public Debt and Economic Growth in Zambia (1980-2017)



Source: World Bank (2018)

The trends portrayed in Figure 1 indicate that Zambia's economic growth was not stable between 1980 and 1998, reaching a period low of -9.8% in 1994 (World Bank, 2018). However, there was an economic rebound from 2000 until 2014 in which annual economic growth averaged 4.6%, with a period peak of 8.7% in 2010 (World Bank, 2018). The steady increase in annual real GDP per capita growth rate during this period – 2000 to 2014 – can be attributed to increased copper output, high copper prices, increased power supply and a boost in agricultural exports (International Bank for Reconstruction and Development, 2017). As Figure 1 depicts, the economic growth rate eased in 2015, 2016 and 2017, recording 1.4%, 0.9% and 1.0%, respectively (MOF, 2017). The economic slowdown followed poor achievements in the services, extractive and construction industries beginning the end of 2015 (World Bank, 2016b).

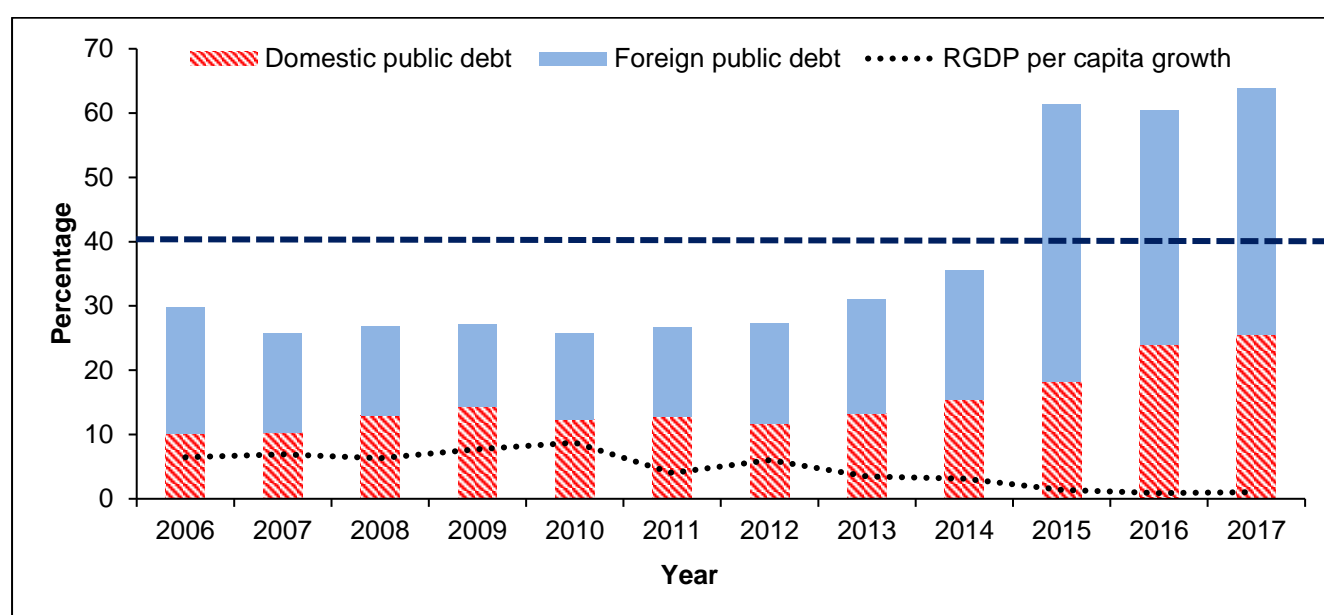
With respect to public debt dynamics in Zambia, Figure 1 shows that there are three episodes: (1) 1980 to 2004, in which government debt exceeded national output; (2) 2005 to 2014, in which public debt levels were below 40% of GDP; and (3) 2015 to 2017, in which public debt levels exceeded the World Bank and IMF debt sustainability threshold of 40% of GDP, averaging 59.9% (World Bank, 2018; IMF, 2017a).

The rise in domestic public debt has also been associated with an exponential increase in foreign public debt since 2006. Zambia had been borrowing extensively since the 1970s, but the debt relief initiatives extended to it by the international creditor community beginning early-1990s substantially reduced the country's foreign public debt from 148% of GDP in 2004 to 29% in 2006 (World Bank, 2018). The period stretching from 1970 to 2000 was characterised by persistent current account deficits such that the central government relied almost entirely on borrowing from global financial institutions and capital markets to finance the fiscal gap – hence this period is referred to in some literature as ‘foreign debt-led’ period (African Forum and Network on Debt and Development, 2011; GRZ, 2006).

Further, the swift accumulation in foreign indebtedness after 2006 is likely to have been caused by a mixture of factors, such as new non-concessionary borrowing from international capital markets, the issuance of Eurobonds and syndicated loans on international debt markets, and significant real exchange rate depreciations (International Bank for Reconstruction and Development, 2017). Zambia, like many other African countries, has been borrowing on non-concessionary basis from various international creditors, such as China and other emerging market economies, to reduce its fiscal imbalances (IMF, 2017a). Also, Zambia has issued Eurobonds three times since 2012 – in 2012, 2014 and 2015 – with the cumulative value amounting to US\$3 billion in 2016 (IMF, 2017a). The country has also raised US\$450 million in 2016 through a syndicated loan (International Bank for Reconstruction and Development, 2017). Subsequently, foreign public debt grew from US\$1.9 billion (or 8.4% of GDP) in 2011 to US\$8.0 billion in 2016 (or 36.5 % of GDP) (MOF, 2017).

Conclusively, the dynamics of public debt during the period under review are reflected in the rapid changes in both domestic and foreign public debt components, especially after the debt relief initiatives. Figure 2 presents the public sector debt structure of Zambia in the period after the debt relief initiatives, expressed as percentage of real GDP.

Figure 2: Public Sector Debt Structure in Zambia (2006-2017)



Source: Bank of Zambia (2017b)

Figure 2 shows the trends in domestic and foreign public debt in Zambia between 2006 and 2017. Although both components of public debt have been growing since 2006, the rate accelerated after 2015. From 2015 to 2017, an assortment of poor performances in key economic sectors, such as copper mining and agriculture widened the primary deficits and exacerbated both domestic and foreign public borrowing (CSO, 2017; IMF, 2017a). Accordingly, Figure 2 portrays two distinct phases, 2006 to 2014, and 2015 to 2017. In the former phase, public debt levels were sustainable according to the IMF/World Bank sustainability threshold, while in the latter phase, sovereign debt is seen to be unsustainably high placing the country at an excessive risk of debt trouble.

While foreign public debt was driven up by both new external borrowings and exchange rate depreciations, the domestic counterpart was driven by the intensified issuance of state securities and central bank riding loans (Smith *et al.*, 2016). The proportion of domestic public debt to GDP rose from 12.7% in 2011 to 25.6% in 2017 (IMF, 2017a). The rise in domestic debt after 2011 was coming typically from rising issuance of treasury bills, treasury bonds and accumulation of arrears and financing from the banking system (IMF, 2017a).

3. Public Debt and Economic Growth: A Review of Literature

Although the relationship between public debt and economic growth has been scrutinised vastly in the literature, the outcomes have been inconclusive. Until now, there are four perspectives in the literature about the correlation between public debt and economic growth.

The first view argues that there is a strong negative association between public debt and economic growth caused by debt overhang (Myers, 1971), crowding out effect (Krugman, 1988; Diamond, 1965; Modigliani, 1961) and fiscal illusion (Patinkin, 1965). This argument has been widely supported empirically by Huang *et al.* (2018), Gómez-Puig and Sosvilla-Rivero (2018), Soydan and Bedir (2015), Ewaida (2017); Broner *et al.* (2014), Lof and Malinen, 2014); Reinhart *et al.* (2012) and Cochrane (2011), among others.

The second view states that sovereign debt positively influences economic growth and is supported in literature by the dual gap theory (Chenery and Strout, 1966; McKinnon, 1964), the Wagner's hypothesis of "Law of increasing state activity" (Kobayashi, 2015; Wagner, 1893) and the Keynesians' fiscal multiplier effect (Rebelo, 1995; Arrow and Kuz, 1970). Empirically, this premise is backed by studies such as Balcilar (2012), Greiner (2011), Abu-Bakar and Hassan (2008), Abbas and Christensen (2007), and Cohen (1992).

The third view states that the link between public debt and economic growth exhibits a nonlinear form (see Sachs, 1989; Krugman, 1988). The empirical work which is linked to this hypothesis comprises Dogan and Bilgili (2014), Baum *et al.* (2012), Minea and Parent (2012), Cecchetti *et al.* (2011), Checherita-Westphal and Rother (2010), and Reinhart and Rogoff (2010a, 2010b). Finally, is the view that public debt and economic growth have a neutral relationship (see Barro in 1974; 1989; Buchanan in 1976). The empirical studies which are associated with this supposition comprises Kourtellos *et al.* (2013) and Schclarek (2004).

The effect of sovereign debt on economic growth is the joint impact of both foreign and domestic debt. Pertaining to the link between foreign public debt and economic growth, considerable empirical work has been done in developing countries (See Zaman *et al.*, 2013; Clements *et al.*, 2003; Nguyen *et al.*, 2003; Pattillo *et al.*, 2002, among others). The bulk of these empirical studies support the view that high foreign public debt levels act as an impediment to capital accumulation in the domestic economy and lead to capital flight (See Salotti and Tcecroci, 2012; Rodrik, 2008; Clements *et al.*, 2003; Moss and Chiang, 2003;

Nguyen *et al.*, 2003). Furthermore, Borenzenstein *et al.* (2004) assert that foreign public debt leads to future public policy scepticism as governments may revert to increased taxation and exchange rate changes. However, a study by Romero and Burkey (2011) reveal that low foreign public debt levels can have positive impact on economic growth.

The repercussions of sovereign debt on economic performance is not restricted to foreign debt, but it also comprises domestic debt. According to Beaugrand *et al.* (2002), domestic public debt to finance fiscal gap may be more costly than concessionary foreign public debt, owing to its crowding out effect on private sector investment – induced by high domestic interest rates (see also Diamond, 1965). When governments borrow excessively from local debt markets, it will be using domestic private savings to fund its recurrent expenditures – mostly consumptive – thus reducing financial resources available for private lending (Ewaida, 2017). The disproportionate domestic public borrowing can lead to high debt servicing costs, especially when foreign interest rates are lower than local ones (World Bank, 2001).

According to the IMF (2012), the rise in domestic interest rates may be more striking if the investor base is ordinarily narrow and exceptionally concentrated (see also Arnone and Presbitero, 2010). Further, Fischer and Easterly (1990) purport that, if interest rates are administered, government borrowing on the domestic markets may cause disproportionate credit apportionment and crowding out of private sector investment. Contrary to these views, Arnone and Presbitero (2008) state that domestic public debt reduces both heavy dependence on foreign aid and sovereign exposure to interest rate and currency risks, and also limits external financial outflows. Hence, domestic public borrowing can help deepen money and financial markets, and thus assist in savings mobilisation (Gulde *et al.*, 2006; Moss *et al.*, 2006).

Compared to foreign public debt, domestic public debt tends to have prohibitive interest rates, which entail higher public debt service costs; and short maturity periods, which aggravate fiscal imbalances and default risks (Akemann and Kanczuk, 2005). Thus, according to Panizza (2012) and Bua *et al.* (2014), most developing countries are trading currency mismatch risk for maturity mismatch risk.

4. Estimation Techniques and Empirical Analysis

4.1 Empirical Model Specification

In this section, the dynamic impact of public debt and economic growth, and domestic vs. foreign public debt on economic growth in Zambia is analysed using the autoregressive distributed lag (ARDL) bounds testing methodology. The ARDL bounds testing technique is adopted in this study over alternative conventional cointegration methods in view of its several advantages. First, whereas the other conventional cointegration methods require that regression variables be of equal order of integration, the ARDL procedure can produce meaningful and reliable parameters as long as the predictor variables are purely integrated of at most one (Nindi and Odhiambo, 2014).

Second, unlike in conventional cointegration testing methods, which use a system of equations, the ARDL methodology is parsimonious as it applies only a single reduced form equation (see Pesaran and Shin, 1999). Third, the ARDL testing procedure yields robust results even in small or finite data sample sizes, unlike the Engle and Granger (1987) test and the Full-Maximum Likelihood (FML) test which are responsive to the sample magnitude (Solarin and Shahbaz, 2013; Odhiambo, 2008; 2009). Finally, an ARDL technique estimates simultaneously the short-run and long-run parameters and the parameters are consistent and unbiased (see Odhiambo, 2009; 2011).

In light of these strengths, the ARDL procedure is thought as well-suited method for investigating the underlying relationships specified in this study. The study employs two models: Model 1 scrutinises the impact of public debt on economic growth, while Model 2 explores the relative impact of domestic and foreign public debt on economic growth. For the purpose of fully specifying the models (Model 1 and Model 2), six control variables were added to each model. These additional control variables are gross domestic investment (I), labour (L), fiscal balance (FB), trade openness (TOP), domestic savings (S), and terms of trade (TOT). According to the exogenous, endogenous, Keynesian and neoclassical economic growth theories, the six added explanatory variables positively affect economic growth (see Anyanwu, 2014; Checherita-Westphal and Rother 2012; Greiner, 2012; Berg and Krueger, 2003; Fischer, 1992; 1993; Khan, 1987; Lucas, 1988) – implying that their coefficients are also projected to be positive. The regression variables in the two models are described in Table 1.

Table 1: Summary of Regression Variables

Notation	Variable description
y	Annual growth rate of real GDP per-capita (a proxy for economic growth)
PD	Percentage of public debt in GDP (a proxy for public debt)
DPD	Percentage of domestic public debt in GDP (a proxy for domestic public debt)
FPD	Percentage of foreign public debt in GDP (a proxy for foreign public debt)
I	Percentage of gross fixed capital formation in GDP (a proxy for gross domestic investment)
L	Percentage of economically active population aged between 15 and 64 years in total working age population (a proxy for labour)
FB	Percentage of fiscal balance in GDP (a proxy of fiscal balance)
TOP	Trade openness (a proxy for trade openness)
S	Percentage of gross domestic savings in GDP (a proxy for savings)
TOT	Percentage of trade balance in GDP (a proxy for terms of trade)

The two ARDL models and their associated error correction (ECM) models are specified in equations 1 to 4 as follows:

ARDL specification for Model 1: Impact of public debt on economic growth

$$\begin{aligned}
 \Delta y_t = & \alpha_0 + \sum_{i=1}^n \alpha_{1i} \Delta y_{t-i} + \sum_{i=0}^n \alpha_{2i} \Delta PD_{t-i} + \sum_{i=0}^n \alpha_{3i} \Delta I_{t-i} + \sum_{i=0}^n \alpha_{4i} \Delta L_{t-i} \\
 & + \sum_{i=0}^n \alpha_5 \Delta FB_{t-i} + \sum_{i=0}^n \alpha_6 \Delta TOP_{t-i} + \sum_{i=0}^n \alpha_{7i} \Delta S_{t-i} + \sum_{i=0}^n \alpha_{8i} \Delta TOT_{t-i} \\
 & + \sigma_1 y_{t-1} + \sigma_2 PD_{t-1} + \sigma_3 I_{t-1} + \sigma_4 L_{t-1} + \sigma_5 FB_{t-1} + \sigma_6 TOP + \sigma_7 S_{t-1} \\
 & + \sigma_8 TOT_{t-1} + \mu_{1t} \dots \dots \dots (1)
 \end{aligned}$$

Where α_0 is a constant; $\alpha_1 - \alpha_8$ and $\sigma_1 - \sigma_8$ are short-run and long-run regression coefficients, respectively; Δ denotes a change; n are lag lengths; μ_{1t} is white-noise error term; and t is time period.

ECM specification for Model 1: Impact of public debt on economic growth

$$\begin{aligned}\Delta y_t = & \alpha_0 + \sum_{i=1}^n \alpha_{1i} \Delta y_{t-i} + \sum_{i=0}^n \alpha_{2i} \Delta PD_{t-i} + \sum_{i=0}^n \alpha_{3i} \Delta I_{t-i} + \sum_{i=0}^n \alpha_{4i} \Delta L_{t-i} \\ & + \sum_{i=0}^n \alpha_{5i} \Delta FB_{t-i} + \sum_{i=0}^n \alpha_{6i} \Delta TOP_{t-i} + \sum_{i=0}^n \alpha_{7i} \Delta S_{t-i} + \sum_{i=0}^n \alpha_{8i} \Delta TOT_{t-i} \\ & + \omega_1 ECM_{t-1} + \mu_{2t} \dots \dots \dots (2)\end{aligned}$$

Where α_0 is a constant; $\alpha_1 - \alpha_8$ and ω_1 are regression coefficients; Δ denotes a change; n are lag lengths; μ_{2t} is white-noise error term; ECM_{t-1} is the error-correction term lagged once; and t is time period.

ARDL specification for Model 2: Relative impact of domestic and foreign public debt on economic growth

$$\begin{aligned}\Delta y_t = & \lambda_0 + \sum_{i=1}^n \lambda_{1i} \Delta y_{t-i} + \sum_{i=0}^n \lambda_{2i} \Delta DPD_{t-i} + \sum_{i=0}^n \lambda_{3i} \Delta FPD_{t-i} + \sum_{i=0}^n \lambda_{4i} \Delta I_{t-i} \\ & + \sum_{i=0}^n \lambda_{5i} \Delta L_{t-i} + \sum_{i=0}^n \lambda_{6i} \Delta FB_{t-i} + \sum_{i=0}^n \lambda_{7i} \Delta TOP_{t-i} + \sum_{i=0}^n \lambda_{8i} \Delta S_{t-i} \\ & + \sum_{i=0}^n \lambda_{9i} \Delta TOT_{t-i} + \rho_1 y_{t-1} + \rho_2 DPD_{t-1} + \rho_3 FPD_{t-1} + \rho_4 I_{t-1} \\ & + \rho_5 L_{t-1} + \rho_6 FB_{t-1} + \rho_7 TOP_{t-1} + \rho_8 S_{t-1} + \rho_9 TOT_{t-1} + \mu_{3t} \dots \dots \dots (3)\end{aligned}$$

Where λ_0 is a constant; $\lambda_1 - \lambda_8$ and $\rho_1 - \rho_8$ are short-run and long-run regression coefficients, respectively; Δ denotes a change; n are lag lengths; μ_{3t} is white-noise error term; and t is time period.

ECM specification for Model 2: Relative impact of domestic and foreign public debt on economic growth

$$\begin{aligned}\Delta y_t = & \lambda_0 + \sum_{i=1}^n \lambda_{1i} \Delta y_{t-i} + \sum_{i=0}^n \lambda_{2i} \Delta DPD_{t-i} + \sum_{i=0}^n \lambda_{3i} \Delta FPD_{t-i} + \sum_{i=0}^n \lambda_{4i} \Delta I_{t-i} \\ & + \sum_{i=0}^n \lambda_{5i} \Delta L_{t-i} + \sum_{i=0}^n \lambda_{6i} \Delta FB_{t-i} + \sum_{i=0}^n \lambda_{7i} \Delta TOP_{t-i} + \sum_{i=0}^n \lambda_{8i} \Delta S_{t-i} \\ & + \sum_{i=0}^n \lambda_{9i} \Delta TOT_{t-i} + \omega_2 ECM_{t-1} + \mu_{4t} \dots \dots \dots (4)\end{aligned}$$

Where λ_0 is a constant; $\lambda_1 - \lambda_8$ and ω_2 are regression coefficients; Δ denotes a change; n are lag lengths; μ_{4t} is white-noise error term; ECM_{t-1} is the error-correction term lagged once; and t is time period.

4.2 Data Sources

This paper applied yearly time-series data stretching from 1970 to 2017. The primary source of data in this study is the World Bank Development Indicators, 1970-2017 (World Bank, 2018) where annual real GDP per capita growth (y), gross public debt (PD), gross fixed capital formation (I), labour participation rate (L), fiscal balance (FB), trade openness (TOP), savings (S) and terms of trade (TOT) were retrieved. Domestic and foreign public debt were acquired from the electronic database of the Bank of Zambia (Bank of Zambia, 2017b).

4.3 Stationarity Tests

Similar to other time series data techniques, this study performed stationarity tests using the Dickey-Fuller Generalised Least Square (DF-GLS), the Phillips-Perron (PP) and the Perron (PPURoot) unit root tests. The lag lengths in DF-GLS, PP and PPURoot were spontaneously chosen by Schwarz Information Criterion (SIC), Newey-West bandwidth and Perron Unit Root test truncation lag techniques, respectively. The stationarity tests were performed to establish the order of integration in the series. The results of stationarity checks are reported in Table 2.

Table 2: Stationarity Test Results – All Variables

Variable	Dickey-Fuller Generalised Least Square (DF-GLS) Test				Phillips-Perron (PP) Test				Perron, 1997 (PPURoot) Test			
	Stationarity of all variables in levels		Stationarity of all variables in first difference		Stationarity of all variables in levels		Stationarity of all variables in first difference		Stationarity of all variables in levels		Stationarity of all variables in first difference	
	Without trend	With trend	Without trend	With trend	Without trend	With trend	Without trend	With trend	Without trend	With trend	Without trend	With trend
y	-3.295***	-6.219***	-	-	-5.592***	-6.116***	-	-	-6.831***	-6.917***	-	-
PD	-1.890*	-2.616	-	-6.131***	-1.857	-2.689	-7.378***	-7.442***	-4.194	-4.157	-8.257***	-8.169***
DPD	-0.357	-1.402	-6.029***	-6.620***	-1.096	-1.367	-6.748***	-6.711***	-4.183	-4.045	-9.735***	-9.748***
FPD	-1.318	-1.383	-5.424***	-5.538***	-1.521	-1.451	-5.239***	-5.860***	-3.335	-4.748	-8.244***	-8.345***
I	-1.078	-1.394	-6.476***	-6.771***	-1.065	-1.436	-6.576***	-6.819***	-6.979***	-6.865***	-	-
L	-1.615	-2.039	-1.866*	-2.900*	-1.702	-0.164	-5.930***	-7.617***	-3.860	-3.668	-5.361*	-5.480*
FB	-3.267***	-5.167***	-	-	-3.302**	-5.204***	-	-	-5.802**	-8.534***	-	-
TOP	-2.045**	-2.874	-	-6.307***	-2.888**	-2.999	-	- 10.254***	-3.084	-3.292	-6.812***	-6.787***
S	-1.538	-1.982	-5.953***	-7.935***	-2.714*	-2.862	-	- 10.161***	-4.864	-5.109	-8.906***	-9.087***
TOT	-1.513	-3.263**	-4.570***	-	-3.532**	-3.272*	-	-	-6.897***	-7.717***	-	-

*Note: *, ** and *** imply stationarity at 10%, 5% and 1% significance levels, respectively.*

The stationarity results reported in Table 2 tend to differ depending on the unit root testing method used. Overall, all the variables turn out to be stationary in levels, $I(0)$, or in first difference, $I(1)$, thus validating the aptness of the ARDL bounds estimation technique.

4.4 Bound F-statistic Test Results

In this section, the existence or nonexistence of a long-run connection between the regression variables in the two models is analysed using a bounds F-statistic test. The results of the bounds F-statistic test are displayed in Table 3.

Table 3: ARDL bounds Test for Cointegration Results – Models 1 and 2

Model	Dependent variable	Function	F-statistic	Cointegration status			
1	y	F(y PD, I, L, FB, TOP, S, TOT)	4.614***	Cointegrated			
2	y	F(y DPD, FPD, I, L, FB, TOP, S, TOT)	4.161***	Cointegrated			
Asymptotic critical values (Unrestricted intercept and no trend)							
Pesaran <i>et al.</i> (2001: 300) critical values		10%		5%		1%	
		I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
[Table CI(iii) Case III]: Model 1		2.03	3.13	2.32	3.50	2.96	4.26
[Table CI(iii) Case III]: Model 2		1.95	3.06	2.22	3.39	2.79	4.10

Note: *** signify statistical significance at 1%.

The calculated F-statistic values for Model 1 and Model 2 reported in Table 3 are 4.614 and 4.161, respectively. The calculated F-statistic values are all above the respective upper bound Pesaran *et al.* (2001: 300) critical values of 4.26 and 4.10 at 1% significance level. The cointegration results, therefore, substantiate the existence of a long-run stable association between public debt and economic growth, and between domestic and foreign public debt and economic growth, hence, the study proceeds to empirically estimate the models.

4.5 Impact Analysis

Following the confirmation of long-run relationships among the regression variables in Models 1 and 2, the paper proceeds to estimate the models using the ARDL method. The optimal lag length for the ARDL Model 1 and Model 2 were selected based on either the AIC or BIC techniques. Based on the model's explanatory predictive power, the study selected AIC-based ARDL (1, 1, 2, 0, 3, 0, 3, 2) for Model 1 and AIC-based ARDL (3, 3, 2, 3, 3, 2, 2, 3, 1) for Model 2. The long- and short-run regression coefficients are reported in Table 4.

Table 4: Long-Run and Short-Run Results for Models 1 and 2

Panel A: Long-run coefficients (Explained variable is y)				
	Model 1		Model 2	
Regressors	Coefficient	T-ratio	Coefficient	T-ratio
C	-12.090***	-2.932	-41.300***	-3.105
PD	0.019*	1.755	-	-
DPD	-	-	-0.047***	-3.037
FPD	-	-	0.022**	2.709
I	0.249*	1.888	0.439*	1.771
L	0.089*	1.725	0.315	1.668
FB	-0.446*	-1.707	0.235	1.378
TOP	-0.334**	-2.534	-0.317**	-2.948
S	0.537*	1.924	0.285*	1.891
TOT	-0.123	-0.231	-0.592**	-2.496
Panel B: Short-run coefficients (Explained variable is Δy)				
Regressors	Coefficient	T-ratio	Coefficient	T-ratio
$\Delta y(1)$	-	-	0.193**	2.675
$\Delta y(2)$	-	-	0.160	1.037
ΔPD	0.042*	2.015	-	-
ΔDPD	-	-	-0.134	-0.329
$\Delta DPD(1)$	-	-	-0.089**	-2.512
$\Delta DPD(2)$	-	-	-0.157***	-2.986
ΔFPD	-	-	-0.001	-0.036
$\Delta FPD(1)$	-	-	0.083***	3.839
ΔI	0.273*	1.787	0.571***	3.341
$\Delta I(1)$	0.223*	1.855	0.036	0.198
$\Delta I(2)$	-	-	-0.266*	-1.752
ΔL	0.823	1.614	0.232***	3.365
$\Delta L(1)$	-	-	-0.574	-1.141

$\Delta L(2)$	-	-	0.344	1.489
ΔFB	-0.076	-0.743	0.026	0.202
$\Delta FB(1)$	0.182	1.337	-0.305***	-3.086
$\Delta FB(2)$	-0.181**	-2.050	-	-
ΔTOP	-0.322**	-2.513	-0.226**	-2.615
$\Delta TOP(1)$	-	-	-0.119	-1.081
ΔS	0.190	1.237	0.402***	3.467
$\Delta S(1)$	-0.054	-0.353	-0.130***	-2.959
$\Delta S(2)$	0.200*	1.808	-0.315	-1.668
ΔTOT	0.382	0.842	0.300***	3.105
$\Delta TOT(1)$	-0.883*	-1.955	-	-
$ECM(-1)$	-0.263***	-5.481	-0.485***	-4.931
	Model 1		Model 2	
R-squared	0.772		0.907	
R-bar-squared	0.523		0.707	
F-statistic	4.700		4.545	
Prob (F-statistic)	0.001		0.002	
DW statistic	1.742		1.731	
SE of Regression	3.433		2.446	
Residual Sum of Squares	94.615		83.726	
Akaike Info. Criterion	-86.1299		-108.822	
Schwartz Bayesian Criterion	-104.195		-136.825	

Note that: * = 10%, ** = 5%, and *** = 1% statistical significance. Δ = first difference operator.

The long-run results for Model 1 reported in Table 4 Panel A indicate that the coefficient of public debt (PD) is positive and statistically significant at 10% significance level. This implies that public debt has a distinguished positive long-run impact on economic growth (y) in Zambia. The finding suggests that public debt in Zambia has, on average, largely been used to expand the tradable sector. In other words, the results suggest that a considerable amount of public debt may have been financing capital expenditure, hence impacting positively to enhance economic activity.

The adoption of stringent expenditure, financial, economic and debt reforms since the late 1990s might have helped to reduce and, in some instances, maintain sustainable public debt levels and to channel new debt into productive sectors (IMF, 2017a; MOF, 2014a; Government of Zambia “GRZ”, 2007, World Bank, 2001). For instance, in 2004, the country implemented several private investment growth initiatives under the Private Sector Development Reform Program (PSDRP), while newly contracted government debt was committed to energy sector expansion and transport sector

development (GRZ, 2017; 2004). This finding, although contrary to the study expectations, it compares favourably with other earlier studies on the topic, such as Gómez-Puig, and Sosvilla-Rivero (2018), Dreger and Reimers (2013), DeLong and Summers (2012), and Romero and Burkey (2011), among others.

The long-run results of other variables for Model 1 displayed in Table 4 Panel A reveal that the coefficients of investment (I), labour (L) and savings (S) are as expected, positive and statistically significant at 10% significance level. It follows that these three variables positively influence economic growth in Zambia in the long run. Contrary to the study expectations, the coefficients of fiscal balance (FB) and trade openness (TOP) are negative and statistically significant at 10% and 5% significance level, respectively. These study results signify that both fiscal balance and trade openness have a negative long-run effect on economic growth in Zambia. The incessant fiscal deficits since the 1980s and increased inflows of finished products might have contributed to the noticeable negative effect on long-run economic growth in Zambia (BOZ, 2015). Finally, the coefficient of terms of trade (TOT) is statistically insignificant.

The short-run results for Model 1 reported in Table 4 Panel B show that the coefficient of public debt (ΔPD) is positive and statistically significant at 10% significance level. This implies that an upsurge in public debt in Zambia in the current period can bring about an increase in economic growth in the short run. This finding compares favourably with other recent empirical studies by Gómez-Puig, and Sosvilla-Rivero (2018) and Dreger and Reimers (2013), among others. The short-run results of other variables for Model 1 reported in Table 4 Panel B reveal that the coefficients of investment (ΔI and $\Delta I(1)$) are positive as anticipated and statistically significant at 10% significance level. This finding suggests that a rise in investment in the current and previous periods can enhance economic growth in the short run. Further, the short-run results reveal that labour (ΔL) made no significant impact on economic growth in the short run in Zambia.

Also, the short-run results for Model 1 show that the coefficients of fiscal balance ($\Delta FB(2)$) and terms of trade ($\Delta TOT(1)$) are negative and statistically significant at 5% and 10%, respectively. This suggests that fiscal balance and terms of trade in the past period have a negative impact on economic growth in the short run. Furthermore, the short-run coefficient of trade openness ($\Delta TOP(1)$) is negative and statistically significant at 5%. This outcome suggests that an increase in trade openness

in the current period has a negative impact on economic growth in the short run in Zambia. Finally, as anticipated, the error correction term $ECM(-1)$ turns out to be negative and statistically significant at 1%, implying that in the event of a shock to the Zambian economy, economic growth adjusts to equilibrium at a rate of 26.3% per annum.

The empirical results of Model 2 reported in Table 4 Panel A indicate that the long-run relative impact of public debt on economic growth in Zambia is dependent on the type of debt under consideration – that is, whether it is domestic or foreign public debt. Whereas domestic public debt negatively affects long-run economic growth, foreign public debt positively impacts economic growth in Zambia. The negative impact of domestic public debt on economic growth may perhaps be due to the crowding out effect of government borrowing on domestic capital markets – further suggesting that the financial markets of Zambia are still narrow and illiquid (see Arnone and Presbitero, 2010; Chartered Accountants and Management Consultants, 2006; McCulloch *et al.*, 2000). As stated in Dahou *et al.*, (2009), in shallow financial markets, a rise in domestic public debt limits access to long-term financing for private borrowers, leading to depressed capital accumulation, economic growth and welfare (see also Atique and Malik, 2012).

In contrast, the net positive long-run impact of foreign public debt on economic growth in Zambia might have started after 2006 when the country embarked on long-term borrowing largely for productive purposes (GRZ, 2015). Although unexpected in this study, the results are in agreement with the finding in Siddiqui and Malik (2001) in which crowding out may occur through credit rationing and a swift build-up in domestic public debt, particularly in the presence of concessionary foreign financing.

The long-run empirical results of other variables in Model 2 show that the coefficients of investment (I) and savings (S) are as projected, positive and statistically significant at 10% significance level. Unexpectedly, the coefficients of trade openness (TOP) and terms of trade (TOT) are negative and statistically significant at 5% significance level. Furthermore, the long-run regression coefficients of labour (L) and fiscal balance (FB) turns out to be statistically insignificant.

The short-run results for Model 2 reported in Table 4 Panel B show that the coefficients of domestic public debt ($\Delta DPD(1)$ and $\Delta DPD(2)$) are negative and statistically significant. This suggests that a

rise in domestic public debt in the previous period in Zambia can lead to economic decline in the short run. This finding infers that domestic public debt has a net crowding out effect on economic growth in Zambia in the short run. Further, the short-run coefficient of foreign public debt ($\Delta FPD(1)$) is positive and statistically significant at 1% significance level. This result implies that foreign public debt in the past period has an unexpected positive impact on economic growth in the short run.

The short-run results of other variables in Model 2 reveal that the coefficients of investment (ΔI), labour (ΔL), savings (ΔS) and terms of trade (ΔTOT) are positive and statistically significant. This outcome reveals that investment, labour, savings and terms of trade in the current period positively impact economic growth in the short run. Furthermore, economic growth ($\Delta y(1)$) in the past period positively affects economic growth in the short run. The short-run results for Model 2 also reveal that investment ($\Delta I(2)$), fiscal balance ($\Delta FB(1)$) and savings ($\Delta S(1)$) in the previous period negatively influences economic growth in the short run. The impact of trade openness (ΔTOP) on economic growth in the current period is unpredictably found to be negative and statistically significant. Finally, as anticipated, the error correction term $ECM(-1)$ turns out to be negative and statistically significant at 1%, implying that in the event of a shock to the Zambian economy, economic growth adjusts to equilibrium at a rate of 48.5% per annum.

Four diagnostic tests, namely, serial correlation, functional form, normality and heteroscedasticity, were performed on the ECM-based ARDL Models 1 and 2; and the outcomes are presented in Table 5.

Table 5: Diagnostic Test Results – Models 1 and 2

LM test statistic	Results [Probability]	
	Model 1	Model 2
Serial Correlation: CHSQ (1)	0.493 [0.483]	2.091 [0.148]
Functional Form: CHSQ (1)	0.735 [0.391]	0.282 [0.595]
Normality: CHSQ (2)	0.892 [0.640]	1.534 [0.465]
Heteroscedasticity: CHSQ (1)	0.484 [0.487]	0.041 [0.839]

The results shown in Table 5 indicate that both models passed all the four diagnostic tests carried out. This means that the estimated parameters in the two models are consistent and reliable. Further, to test the null hypothesis of model stability, the study plotted the Cumulative Sum of Recursive Residuals (CUSUM) and Cumulative Sum of Squares of Recursive Residuals (CUMUMSQ) for Model 1 and Model 2 and the results are displayed in Figure 3 Panels A and B, respectively.

Figure 3: Plot of CUSUM and CUMUMSQ – Models 1 and 2

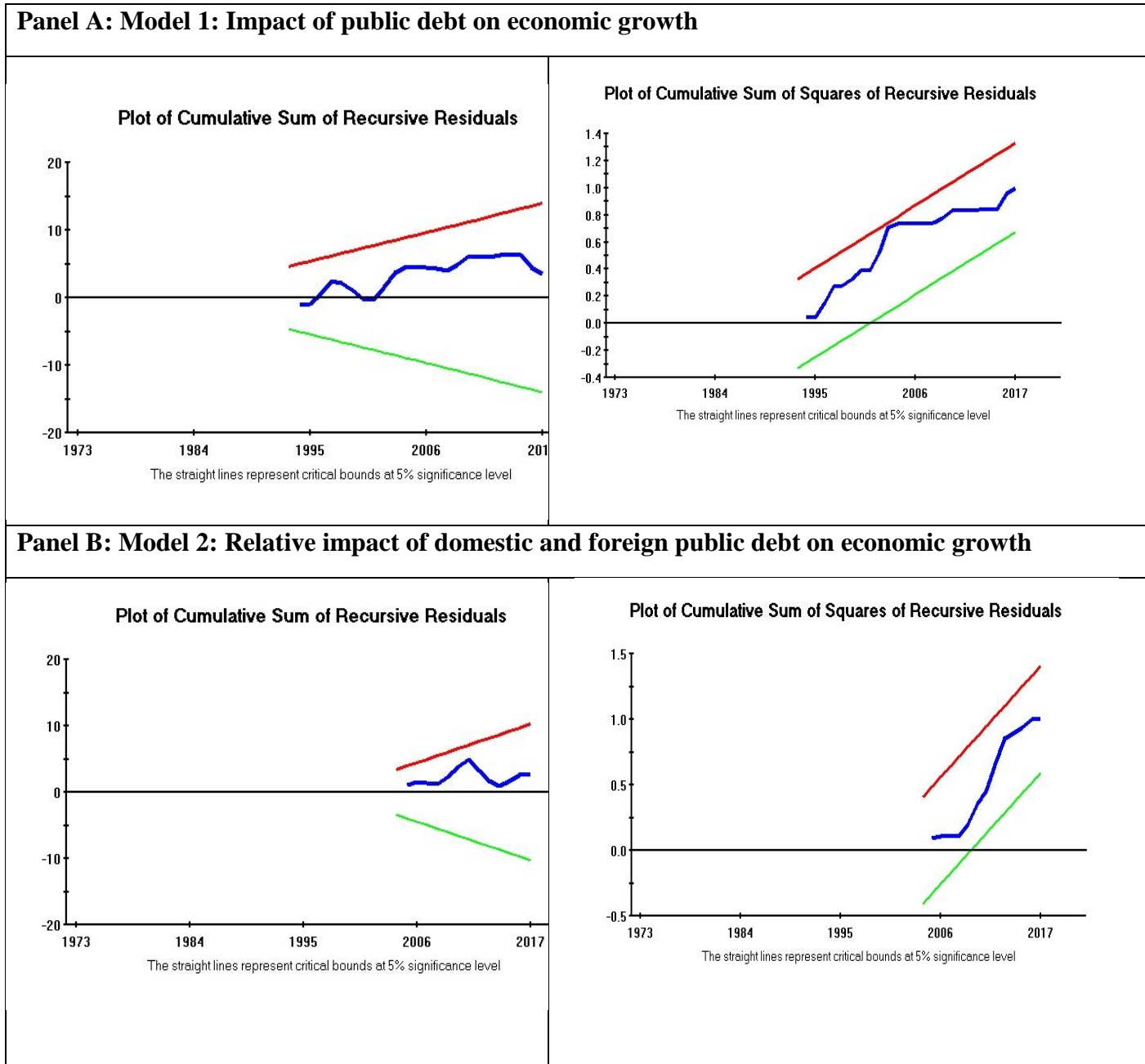


Figure 3 shows that the CUSUM and CUMUMSQ plots for the two models are generally stable at 5% significance level, thus failing to reject the null hypothesis of stability of the regression coefficients.

5. Conclusion

In this study, the impact of public debt on economic growth in Zambia was examined for the period from 1970 to 2017. Also examined was the relative impact of domestic and foreign public debt on Zambia's economic growth. The Zambian economy is among the fastest growing economies in sub-Saharan Africa and the country is on track towards being an upper middle-income country as stated in the country's vision 2030 policy document (MOF, 2006). Of the many previous studies that were done on the relationship between public debt and economic growth in sub-Saharan Africa, the majority focussed on the impact of foreign public debt on economic growth.

Therefore, this study differs from other previous empirical studies in that it analysed, in detail, how public debt and its components – domestic and foreign – impact on economic growth in Zambia. This approach allowed for an in-depth understanding of the public debt-economic growth nexus in this country. Further, unlike the previous studies that used the conventional cointegration approaches, mostly the Engle and Granger (1987) test and the Full-Maximum Likelihood (FML) test which are sensitive to the size of the sample, this study employed the ARDL methodology which provides robust results even in small or finite data sample sizes.

The empirical results of this study reveal that aggregate public debt has a positive impact on economic growth in Zambia, both in the short run and long run. The results of the study further show that the relative impact of public debt on economic growth in Zambia is dependent on the type of debt under consideration, that is, whether it is domestic or foreign debt. Domestic public debt turns out to have a negative impact on economic growth, while its foreign counterpart had a positive impact, and the relationships apply both in the short run and long run.

In line with the study findings, the study recommends the following: (1) strengthening of the Integrated Financial Management Information System, the Public Expenditure Tracking Surveys, and

the Treasury Single Account systems to promote more efficient and sustainable domestic public debt levels; (2) upholding of political will to ensure fiscal balance sustainability and channelling of borrowed funds to the tradable sector and to projects with high returns; (3) effective monitoring of government contingency liabilities to minimise fiscal risks (for example, comprehensive recording and analysis of all sovereign guarantees); (4) sound management of government debt composition and structure to reduce currency and maturity risks; (5) expansion of the country's investor base to enhance the flexibility and stability of the government's funding strategy; and (5) promoting gross investment and savings growth through effective monitoring and evaluation of public sector investments to ensure that they deliver value for money; and setting up of tax incentives that promote private sector participation in the economy.

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